IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1983

No. 83-699

AMERICAN INDUSTRIES, LTD., a Nevada corporation
SAVAHAI INC., a Nevada corporation, and
ZACK C. MONROE, Petitioners,

-vs-

INTERMODAL CARGO SERVICES, INC., E.D. OSGOOD,
KEN RIDLEY, JOHN MADROSEN, FRED HIGA, GEORGE
CASSSELLA and JACK MASLANIAK, Respondents.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

REPLY OF PETITIONERS

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I

REPLY TO STATEMENT OF THE CASE

A. Misstatement of Evidence of Misconduct.

The reference in Respondents' Opposition ("Rs. Op.") to MONROE's failure to attend a deposition and "feigned loss of memory" at a deposition (Rs. Op. p8) were not introduced into evidence or proven. Similarly, there was no evidence of MONROE "frequently interfering in the depositions of others" (Rs. Op. p8). The Findings and Conclusions are silent regarding misconduct, except as to characterize MONROE's testimony as "...to be viewed with extreme caution" and less believable than other witnesses (Findings, p7 of Petition Appendix). Respondents' characterizations of MONROE's conduct as "calculated to disrupt and delay proceedings", "intransigent", "undaunted in his deceptions" (Rs. Op. p7, 8) are unsupported by the Findings and are but an example of the baseless invective which has obscured, rather than enlightened, issues in the Courts below.

Significance Of The Misstatement Of Evidence Presented

The award of all of Respondents' fees amounting to over $95,000 could not possibly be compensatory for the procedural misconduct set forth in the Petition. Furthermore, the District Court did not even consider these additional allegations of misconduct set forth in Respondents' Opposition Brief in making its award. Yet, the record is clear that Respondents' entire legal bill, from pretrial negotiations to the end of trial, was submitted and awarded, to the penny. This is a clear abuse of discretion if it is grounded only upon the procedural misconduct, if any, which was referred to in the District Court's findings.

B. Misstatement of Finding of Bad Faith.

Respondents' Opposition misstates the District Court's findings:

> "Monroe's evasive and disruptive conduct prior to and during the trial amply support the findings that Monroe acted in bad faith in this case" (Rs. Op. p13)

In fact, the Findings of Fact and Conclusions of Law never use the words "bad faith", nor even

what might be argued to be their equivalent, except in describing the tortious conduct for which damages were awarded (see Findings Appendix to Petition).

Significance Of Misstatement Of Findings

As confirmed by the quote in Respondents' Opposition, federal courts have held, "a finding (of bad faith) would have to precede any sanction under the court's inherent powers" (Rs. Op. p19) quoting Monk vs. Roadway Express, Inc., 559 F2d 1378 (5th Cir. 1979), aff'd in part and remanded sub nom Roadway Express, Inc. vs. Piper, 447 US 752 at 767 (1980).

C. Misstatement Of Contract.

Respondents' statement, on page 6 of their Opposition, misstates a crucial matter:

> "In reliance upon MONROE's representations, OSGOOD advanced money to MONROE (through CIRCIELLO) which was supposed to pay MONROE's expenses in mining and refining the gold. (Emphasis added.)

In fact, the contractual language which has been ignored or misstated by Respondents and the District Court throughout the case, is as follows:

1. "Savahai will assure a sufficient quantity of ore (but not limited to such) extracted from its mines to be shipped to a selected smelter of ITI's choice in order to assure an orderly production of the above mentioned quantity of gold. ITI will establish controls to assure the refining process to international standards, complete extraction from the ore shipment, establish safeguards and protect the by-products." (Emphasis added.) Savahai/ITI Agreement of August 26, 1978 (Exhibit "1" to the Complaint.)

2. "Savahai will produce enough smelting ore and ore concentrate for a minimum of 1,000 ounces of gold each and every month as the contractual obligation." (Emphasis added.) Letter from Savahai to Babcock ("CPA" for Respondents) dated November 11, 1978 (Exhibit "2" to the Complaint.)

3. "The August 26, 1978 agreement, approved by ITI Board of Directors on September 5, 1978, was entered into by and between ITI and SAVAHAI, whereby ITI pays SAVAHAI, ONE MILLION TWO HUNDRED TWENTY THOUSAND DOLLARS..... ($1,220,000.00) minimum risk capital for the purpose of exploring and developing mines owned by SAVAHAI, to produce commercial ore as set out in the agreement.

"THEREFORE, ITI understands and acknowledges that the payment to SAVAHAI is at risk and ITI has no recourse to SAVAHAI or AMERICAN INDUSTRIES, LTD., should the exploring and developing fail to produce commercial ore according to the contract." Statement of Understanding, dated September 5, 1978 but found to be actually executed in December, 1978. (Exhibit "B" to Answer, Counterclaim and Third Party Complaint.)

4. In a three-way agreement between Petitioners, ITI and B & W (who contracted to process, smelter and "arrange for a finished product of gold"), dated May 25, 1979, the August 26, 1978 agreement was referred to, and

> "B & W acknowledges that the processing and smelting costs are to be paid by ITI." (Exhibit "D" to the Answer, Counterclaim and Third Party Complaint.)

5. A similar three-way agreement between Petitioners, ITI and D & D (who contracted to excavate the ore and to deliver it to B & W) dated June 14, 1979, contains language recognizing the B & W agreement of May 25, 1979 and that B & W is to "process the material delivered by D & D" (Exhibit "E" to the Answer, Counterclaim and Third Party Complaint).

Significance Of The
Misstatement Of Contract Terms

Respondents' Opposition, Section III (p.23), argues that the parol evidence rule does not apply to the "...(false) promise by MONROE to produce 1,000 ounces of gold per month. (Findings 3:3-10)."

This is true only if the promise is not at variance with the contractual promise. In fact, the contractual promise was: sufficient ore to produce 1,000 ounces of gold per month (with ITI bearing the expense of processing and refining, and the risk of commercial failure). Respondents and the District Court misinterpreted the contractual promise, and the Court of Appeals deemed the error irrelevant because the contract was induced by fraud. Petitioners contend that this was circular logic that prevented Petitioners from proving the contractual promise to rebut the elements or scienter and justifiable reliance, as well as prevented Petitioners from excluding the evidence of the alleged parol promise to produce gold instead of ore.

II

RESPONDENTS ARGUE FOR DISCRETION IN THE TRIAL COURT TO IMPOSE A PUNATIVE AWARD OF ATTORNEYS' FEES, UNRELATED TO PROCEDURAL COSTS, WHENEVER "BAD FAITH" IS FOUND TO HAVE EXISTED, IN ADDITION TO COMPENSATORY DAMAGES FOR THE SAME ACTS

This argument is mirrored in the Memorandum Decision of the Court of Appeals. It explains the

dual reference of the Memorandum Opinion to "misleading business dealings" before suit; and "evasive conduct at trial" as the basis for the general finding of "bad faith". As such, it creates a new exception to the American Rule.

A. Hall vs. Cole Does Not Condone Such Unlimited Power To Impose Attorneys' Fees On The Loser In A Fraud Case.

Hall vs. Cole, 413 U.S. 1 (1973), was a LMRDA case - not fraud. The award of fees was not punative, but was grounded upon "common benefit". Finally, the Court held that, while "'bad faith' is essential to 'fee-shifting' under a 'punishment' rationale", it was unnecessary under a "common benefit" rationale.

The opinion in Hall vs. Cole, supra, described a truism regarding when "bad faith" could be found in the course of a defendants' conduct:

> "It is clear, however, that "bad faith" may be found, not only in actions that led to the lawsuit, but also in the conduct of litigation."

However, it is apparent the Court referred to two different types of circumstances, which yield differing consequences:

1. Bad faith before suit in obdurately refusing to assume clear liability, forcing plaintiffs to sue. Vaughn vs. Atkinson, 369 US 527, 8 LEd 2d 88, 82 SCt 997, reh den 370 US 965, 8 LEd 2d 834, 82 SCt 1578; Bell vs. School Board, 321 F2d 494 (4th Cir. 1963); Rolax vs. Atlantic Coast Railroad, 186 F2d 473 (4th Cir. 1951), and

2. Procedural bad faith during litigation including dilatory action and maintaining a meritless defense. Browning Debenture Holders Committee vs. Dasa Corp., 560 F2d 1078, 1089 (CA-2 1977); Nemeroff vs. Abelson, 704 F2d 652 (2nd Cir. 1983); Lipsig v. Nat'l Student Marketing Corp., 663 F2d 178 (DC Cir. 1980).

B. The Courts Below Based Bad Faith On The Torts For Which They Awarded Compensatory Damages.

Unfortunately, the Court of Appeals was misled and used this general description as a warrant to find bad faith in the fraudulent actions which gave rise to the damages for fraud and, which are by definition, done in "bad faith". Thus, Respondents and the Court of Appeals would have the award of attorney fees automatically

within the trial judge's discretion, in every fraud case, as well as other torts which stem from bad faith: a new departure from the American Rule.

This is not the law enunciated in Hall vs. Cole, supra, or any other decision of the Supreme Court.

C. Assessing Fees For Defending Colorably Against Fraud Is Tantamount To Including Them In Compensatory Damages By Another Name, Where Punative Damages Were Denied.

The question also arises from the Opinion of the Court below and Respondents' argument: Can an award of attorneys' fees be granted in a fraud case which arises from a colorable defense of that fraud? Respondents concede "there is no suggestion" in the record that Petitioners' defense was without "color" (Rs. Op. p22). Therefore, they seem to argue that not only can "fee-shifting bad faith" exist as a state of mind during the commission of fraud that is, somehow, divorced from (and presumably worse than) fraudulent intent, but that fee-shifting bad faith may exist during a defense of fraud, that is colorable. The tort-feaser's knowledge of his

fraudulent intent must be proven to obtain judgment. Yet, when this has been done, his refusal to have admitted guilt (absent which, his defense would be meritless) necessarily blackens him with "vindicativeness, obduracy or male fides" (Rs. Op. p22).

They postulate a tort-feaser who must be proven to have knowingly, and with intent to deceive, made fraudulent representations and ommissions sufficient to justify damages for fraud, who does not admit that knowledge, "colorably"; nevertheless, who somehow can avoid the "vindictiveness, obduracy or male fides" in his defense which justifies an additional award of attorneys' fees. All this being different than procedural bad faith where the measure of fees awarded is related to the procedural cost attributable to the bad faith or meritless defense, and different from punative damages (which were not awarded in this case, though prayed for). Such unlimited discretion in the trial court, if left unchanged, would bring about

the evil of chilling vigorous defense, and render meaningless one of the primary rationales for the American Rule.

III

THE NOTION OF ESSENTIALLY UNLIMITED DISCRETION VESTED IN THE TRIAL COURT TO AWARD ATTORNEY FEES AGAINST DEFENDANTS, IN ADDITION TO COMPENSATORY DAMAGES, FOR THE SAME BAD FAITH ACTS BEFORE LITIGATION, IS NOT FOLLOWED IN OTHER CIRCUITS

A. The Courts Below Attempt To Expand "Bad Faith" To The Point It Is Indistinguishable From Punative Or Additional Compensatory Damage.

The Court of Appeals' approach in this case amounts to nothing less than a back door attempt to redress the problem of modern litigation where the cost of pursuing the remedy renders the victory hollow. It is an attempt to expand the discretion of the trial court to award fees for "bad faith" to a point that such awards will be indistinquishable - except for legal imprecations like "bad faith" - from punative damages, or compensatory damages in cases of fraud. There are many excellent arguments that have been advanced for permiting this (see, e.g.: Kuentzel, The Attorney Fee: Why Not a Cost of Litigation?, 49

Iowa L.Rev. 75 [1963]). However, these arguments were addressed in Alyeska Pipeline Services Co. vs. Wilderness Society, 421 US 240, 247, 95 SCt 1672, 1616 (1975), and found insufficient to change the American Rule.

Here, the Court of Appeals and Respondents attempt, by expanding the "bad faith" exception, to do what this Court has not permitted in a line of cases stretching back almost 200 years; what Congress, the Supreme Court and Legislature of California have declined, as yet, to do.

They seek to establish a fee-shifting bad faith that is somehow divorced from the bad faith that is inherent in fraud; a state of mind worse than fraudulent intent to deceive, yet not quite so bad as to deserve an award of punative damages. By partially grounding the award on "fraudulent and misleading behaviour in his business dealings with plaintiff", the Court below forthrightly advances a new exception. Since the amount of the fees awarded is unrelated to the misconduct in trial, the Court of Appeals clearly has set itself

to the task of punishing tort-feasors who commit their torts with a "fee-shifting bad faith" or detering those who persevere in this state of mind to a discernible degree into the litigation.

B. This Case Presents Squarely The Issue Of The Limits Of Discretion Of The Trial Court With Reference To Bad Faith In Tort Cases.

There is no common benefit, private attorney general, or contractual rationale here. Nor is there a statutory rationale, except Section 18 of the Securities Exchange Act of 1934, 15 USC § 78r, which did not, and could not, properly, have formed the basis for the award, as was argued in the Petition (and is all but conceded by Respondents' Opposition (p17). Unless Petitioners' defense was meritless, the provisions of Section 10 of the Securities Act of 1933 (15 USC 77ic(e)) do not apply.

C. Cases Cited By Respondents Conflict With The Ninth Circuit Or Do Not Support It.

In determining the congruity with the Ninth Circuit of the cases cited by Respondents, three primary variables must be considered: 1) Were fees awarded against an unsuccessful plaintiff or

an unsuccessful defendant; 2) did the conduct which gave rise to the compensatory damages also give rise to the fee-shifting bad faith; 3) Did the amount of the fees awarded bear any relation to the cost to the other litigant of the bad faith?

While the cases cited may use similar language and rely upon similar authority, the factual variables above are determinative of the legal principles employed. None, in fact, support the bare assertion of Respondents or the Courts below that all attorneys' fees may be shifted for conduct of the kind found in this case.

For example, in Perichak vs. Int'l Union of Elec. Radio, 715 F2d 78 (3d Cir. 1983), the Court found that the lies the plaintiff told in prosecuting his wage claim amounted to bad faith and, that in the absence of mitigation, would justify - even mandate - an award of fees. However the Court emphasized that he "...could not have commenced his action except in 'bad faith', nor could he have maintained this action with any

reasonable prospect of prevailing on the merits" (715 F2d at p83). Thus, it was the filing of a meritless complaint which invoked the Court's jurisdiction to award fees against the plaintiff.

Perichak, supra, is also not congruent with this case in that, here, there was an award against all defendants, none of whom were directly found to be lying, nor specifically found to have acted in bad faith (except by their torts) by the District Court, and against whom compensatory damages were awarded - but not punative damages - for the same "misleading" business dealings that the Court found to constitute bad faith. Finally, Perichak, supra, did not deal with the amount or basis of a specific fee award.

In McCandless vs. Great Atlantic & Pacific Tea Co., Inc., 697 F2d 198 (7th Cir. 1983), there was again a plaintiff who commenced a groundless case, and the award was against the plaintiff's attorney who further abused the judicial process. The Court found an award of 1/6th of defendant's legal fees proper "...to punish errant counsel and

compensate the prevailing party for unnecessary expenses" (697 F2d at p202).

Nemeroff vs. Abelson, supra again involved a plaintiff who continued an action in a dilatory manner, after finding no basis for it in discovery. The standard set to determine the amount of fees was in Nemeroff vs. Abelson I, 620 F2d 351 (2nd Cir. 1980) and was defendants' "...reasonable expenses resulting from the bad faith conduct" (620 F2d at p351).

Lipsig vs. Nat'l Student Marketing Corp., supra, was an award of fees for dilatory discovery and courtroom tactics which were meticulously detailed in the reported opinion of the trial court (78 FRD 729-731). It held that, while defendant's filing of a counterclaim which had merit "...may well negate any notion of bad faith in filing, it certainly cannot justify abuse of the judicial process in the **methodology** of its **prosecution**" (underline emphasis added [663 F2d at p182]).

Cornwell vs. Robinson, 654 F2d 685 (10th Cir. 1981) reversed an award of $6,000 fees against a defendant for a frivolous removal petition where the trial judge's interpretation of bad faith was not equated with "...vexatious, wanton or oppressive" behaviour. The court held that more than a weak or legally inadquate case must be shown.

CONCLUSION

After Alyeska, supra, Congress responded to a perceived need to shift fees in certain cases. As Mr. Justice Brennan put it in his opinion in Hensley vs. Eckerhart, ___US___, 103 S.Ct 1933, 76 LEd 2d 240 (1983):

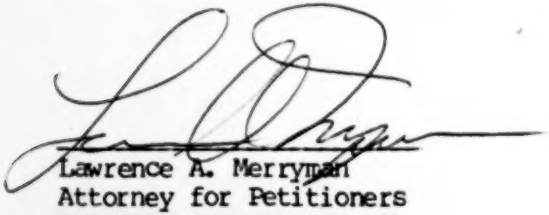
> "Congress, however, has full authority to make those decisions and it responded to the challenge of Alyeska by doing the 'picking and choosing' itself."

Into this constitutionally developed body of law, the decision of the Court of Appeals for the Ninth Circuit injects a note of discord, which, if not corrected, can expand "fee-shifting bad faith" into an unsanctioned and unlimited departure from the American Rule.

To the litigant, it is immaterial whether or not the Courts have inherent power to shift fees as they see fit; so long as in practice, fees are not generally shifted in tort cases, except in accordance with statutes or very limited historical precedents, there will remain a fundamental distinction between the American and English system. It is to preserve the pragmatic basis of that distinction that a Writ of Certiorari should issue to review the judgment and decision of the Ninth Circuit Court of Appeals.

DATED this 13th day of January, 1984.

Respectfully submitted,



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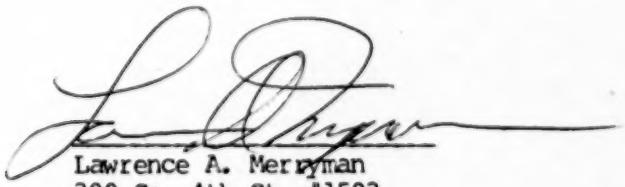
CERTIFICATE OF SERVICE

State of Nevada)
) ss.
County of Clark)

I hereby certify that on this 16 day of January, 1984, three copies of the Reply of Petitioners on Writ of Certiorari were mailed, postage prepaid, to Martin Quinn, ROGERS, JOSEPH, O'DONNELL & QUINN, 505 Sansome Street, 14th Floor, San Francisco, California 94111, Counsel for the Respondent. I further certify that all parties required to be served have been served.

Executed on January 16, 1984 at Las Vegas, Nevada.



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